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Inflation Fears Rise In Japan

Japanese monetary policy during the past 18 months has focused on expanding domestic demand and slowing the appreciation of the yen. In line with this emphasis, the Bank of Japan cut interest rates to record low levels and allowed more rapid growth of the money supply. Now that many economists believe the economy has bottomed out and the exchange rate has been stabilized (at least temporarily), attention is shifting to the effect of monetary policy on prices. The central bank is concerned that the speculative transactions that have boosted the cost of land in urban areas and raised the prices of stocks will rekindle inflation.

Japan's consumer price index in FY 1986 (April 1, 1986-March 31, 1987) was unchanged, the first year since fiscal 1958 that it failed to increase. The appreciation of the yen and the drop in oil prices helped reduce electric

and water utility charges by 7.7 percent, transportation and communication services by 1.5 percent and food prices by 0.8 percent. The stability of prices enabled consumer spending to rise 3 percent in real terms in FY 1986 despite modest wage gains and a worsening employment situation.

Bank of Japan officials, though, believe that wholesale prices, which fell 10 percent in FY 1986, are about to reverse course. One reason is an expected increase in the price of imports resulting from the recent drop in the yen, which closed at Y149.25 on July 6, its lowest rate in over three months. Bank of Japan governor Satoshi Sumita, though, welcomed the dollar's recovery, which he attributed to increased Japanese investment in U.S. securities since March. Ministry of Finance officials believe that net purchases of foreign bonds hit a record high of about $14 billion in June. Japan's May current account surplus, which declined from the year-earlier level for the first time since August 1984, was another reason for the dollar's increased strength relative to the yen.

Higher wholesale prices will in turn raise consumer prices, which already show signs of increasing. The Management and Coordination Agency reported that the cost of living in Tokyo, a bellweather of national inflation trends, rose 0.7 percent in June over a year ago, the third consecutive monthly increase. With pay raises averaging only 3.5 percent this year, it would not take much of a rise in inflation to put a significant dent in workers' real income gains -- a major factor determining consumer spending. Given the probable decline in export volume, steady growth in consumer spending is necessary to achieve the government's 3.5 percent real growth outlook.

Japan's Money Supply

(average outstanding in trillions of yen)

		M2 + CDs	Percentage Change From Year Earlier	Official Discount Rate*
1980		Y197.9	9.2%	7.25%
1981		215.5	8.9	5.5
1982		235.3	9.2	5.5
1983		252.6	7.4	5.0
1984		272.4	7.8	5.0
1985		295.2	8.4	5.0
1986		320.7	8.7	3.0
1987	January	337.4	8.6	3.0
	February	336.0	8.8	2.5
	March	343.7	9.0	2.5
	April	345.5	9.8	2.5
	May**	347.2	10.2	2.5

*End of period
**Preliminary

Source: Bank of Japan

Fears that the booming prices of stocks and real estate will lead to inflation have led the Bank of Japan to ask commercial banks to restrict lending for speculative purchases. The 13 major banks have agreed to limit loans in the July-September period to 5.9 percent above the same quarter a year ago, compared to a 32.9 percent rise in the April-June quarter. Mr. Sumita, though, said he plans to continue the easy monetary policy that resulted in a 10.2 percent rise in the money supply in May, the first double-digit increase since 1982 (see Table). The acceleration of money supply growth, he said, is a natural result of the reduction in the official discount rate from 5 percent at the end of 1985 to a record low of 2.5 percent.

Many economists and government officials, however, believe that there will be no resurgence of inflation in the near future. The Organization for Economic Cooperation and Development, for example, sees consumer prices unchanged in 1987 followed by a 1.75 percent increase in 1988. Many analysts point to the unemployment rate, which rose to a record 3.2 percent in May, as a more serious problem at present.

Randall S. Jones

Fiscal Restraints Loosening

An increasing number of signs point to a turnaround in Tokyo's fiscal policy, at least for the medium-term. After years of spending reductions and high taxes, the Ministry of Finance appears to have lifted its target for FY 1988 spending. A more immediate concern, however, is how to utilize record FY 1986 revenues -- an increase in FY 1987 tax cuts seems most likely.

A subcommittee of the Special Advisory Council on the Enforcement of Administrative Reform, an important advisory committee to the prime minister, has reportedly recommended major increases in public works outlays by lifting the cap on government fixed investment. The panel argued that "fiscal stimulative measures are important as an initial explosive for expanding domestic demand and the construction of social infrastructure" -- and defusing foreign criticism of Japan's large trade surpluses, the subcommittee hopes. Despite all this, the group reiterated the need to balance the budget, but delayed the timetable by saying it should be achieved "as soon as possible" rather than by the current FY 1990 deadline. The report suggested that expenditures for welfare, education, local government subsidies, and energy and agricultural price supports be gradually reduced. As for taxes, it hinted that "an appropriate balance among income, asset and consumption taxes" needs to be struck -- an indirect argument for more of the latter. The full council will discuss the recommendations July 13 before submitting them to the prime minister toward the end of the month.

The Ministry of Finance seems to have already taken the hint by spreading the word that the "minus ceiling" policy will not be in effect for the FY 1988 budget cycle just beginning. Each year since 1983 MOF has urged every government agency to cut current expenditures by 10 percent and investment outlays by 5 percent. Officials appear to have relented on the latter, although the guideline for current spending is still in effect. In addition MOF is considering setting a separate target of Y1.3 trillion ($9.3 billion at Y140=$1.00) for public works spending to keep outlays at or above FY 1987 levels.

Proceeds from the sale of another block of the government's holdings of Nippon Telegraph and Telephone Corp. stock will finance the bulk of the spending.

The Finance Ministry was happily surprised by a record revenue surplus of Y1.8 trillion ($12.9 billion) in fiscal 1986. Revenues rose an unexpected 9.6 percent above FY 1985's Y41.9 trillion ($299.3 billion), yielding a bonus of Y2.4 trillion ($17.1 billion) over predicted receipts. MOF traced the surge to the increased interest income of corporations, which produced an extra Y1,359 billion ($9.7 billion) in corporate taxes; skyrocketing land prices, which boosted real estate, inheritance and income taxes (Y284.9 billion or $2 billion); and booming financial markets, which generated increased securities taxes (Y385.4 billion or $2.8 billion). MOF has allocated Y403 billion ($2.9 billion) to help pay for the fiscal 1987 supplemental budget, while the remaining amount will be transferred to next year's budget. The supplemental budget infusion will allow the government to increase income tax reductions from Y1 trillion to around Y1.4 trillion, a move that should give the economy an immediate shot in the arm. The windfall immediately generated opposition party calls for even greater cuts, but MOF clearly intends to use the money to redeem some of the national debt.

The motives for MOF's abrupt change of heart are complex. As the economy slowed over the past 18 months, Finance officials staunchly retained their tight-fisted spending policy, although they were under pressure to play a more aggressive role. Rising foreign criticism of Japan's increasingly large trade surpluses may also have been a factor, although this too might be a secondary consideration in MOF's eyes. Probably the unexpected revenues were the key that unlocked the spending floodgates. The sale of NTT stock has already yielded approximately Y2.4 trillion ($17.1 billion) and will easily bring in similar amounts over the next several years. Combined with the revenue windfall, Finance has a considerable source of income that does not add to the national debt -- hence its stimulative stance. Concern over the deficit is still strong within MOF, but it is likely to remain submerged for the near term.

Jon Choy

New Era In Japanese Politics

On July 4 a new era dawned in Japan as Noboru Takeshita formally set up his personal faction, drawing from the support of 113 members of the 141-member faction of Kakuei Tanaka. The remaining 28 members affiliated with Susumu Nikaido or declared as independents. Mr. Takeshita has now taken the last step toward his goal to win election as Liberal Democratic Party president and prime minister of Japan next October.

The emergence of the new Takeshita faction marks the end of the long reign of Mr. Tanaka as the most powerful man on the political scene. Mr. Tanaka's influence had been waning since he suffered a serious stroke in February 1985, leaving the day-to-day affairs of the faction to his former confidante Mr. Nikaido. Although most observers agreed that Mr. Takeshita was the most popular figure in the group despite his relative youth, his challenge was to secure the support of the faction without alienating those who remained emotionally loyal to the former faction leader. Mr. Nikaido forced the issue

in a sense by declaring his candidacy for the LDP presidency as the official representative of the faction. This forced Mr. Takeshita to defend his political territory by forming the new faction.

The size of his group leaves Mr. Takeshita in a superior position for the LDP presidential race, which officially has three candidates in the running at this point. Mr. Nikaido declared for the post May 14, while former Foreign Minister Shintaro Abe, now LDP executive council chairman, tossed his hat in the ring June 28. Finance Minister Kiichi Miyazawa is expected to enter the race as well. It is unlikely, however, that all four candidates will remain in the running. In order to qualify candidates must secure the endorsements of 50 LDP Diet members. Factional strength assures endorsements for Messrs. Takeshita, Abe and Miyazawa. In the case of Mr. Nikaido, the going will be a little tougher. Only 17 other members of the Tanaka faction sided with him in the leadership struggle; he must generate an additional 33 to be eligible to run.

Liberal Democratic Party Factions

Faction	Number of Members
Takeshita	113
Miyazawa	89
Abe	85
Nakasone	81
Komoto	32
Nikaido	18
Tanaka neutralists	10
Independents	17

Mr. Tanaka, once the most powerful figure in Japanese politics despite a 1983 bribery conviction in the Lockheed scandal, has seen his influence erode and his support shift to Mr. Takeshita. It is certainly not the end to his career he personally would have preferred. It is unlikely that Mr. Takeshita -- or anyone else -- will be able to match Mr. Tanaka's performance in the coming years in terms of sustained influence.

Yasuhiro Nakasone is now in a position where his influence vis-a-vis other factions is limited. His ability to affect the outcome of the LDP succession race would have been greater had the support for Mr. Takeshita been weaker. Instead, he is now one among many with the ability to secure certain political favors by virtue of his factional strength and position in the Japanese government. But he will not be able to act as the decisive vote in intra-party negotiations.

Michael W. Chinworth

Senate Continues Work On Trade Bill

Despite Senate Majority Leader Robert Byrd's (D, W.Va.) initial hope that action on the trade bill (S 1420) would be completed before the July 4